

VSAT Network Services.

In our two primary geographic markets, the United States and Europe, we now provide full network services through our network management centers, in addition to product sales. We offer a full spectrum of services, from installation and maintenance services to comprehensive service offerings in which we package the VSAT system with installation, network operations, maintenance and access to satellite transponder capacity. Our services include:

- Network Analysis
- Network Implementation
- Shared Hub Services
- Network Operations
- Maintenance
- Customer Technical Services
- Access to Satellite Capacity

In addition, we also provide network services in Argentina and support for network services in India.

Network Analysis. Network analysis involves designing the system in response to specific customer needs, determining critical system parameters, such as data protocols and network response times, assisting in generating component and subsystem specifications for the network's hardware, hub requirements (private or shared), and satellite capacity.

Network Implementation. The network implementation process covers hub installation and network rollout, which entails installing and connecting all of the remote VSAT locations to the network. Network rollouts are planned and managed by the Gilat program management organization. The program manager serves as the customer's single point of contact and is responsible for delivering the network on time, on budget, and to specification.

Many of the activities for installing a VSAT network take place at the customer's facilities, such as: site survey, site preparation and installation of ground, wall, and/or wall-supported mounts with lightning protection, connection of the ODU and IDU to antenna and Inter Facility Link ("IFL") cable, powering up the system, pointing the antenna, initializing the VSAT and confirming proper operation with the hub, connecting the VSAT with the customer's local equipment (such as LAN or POS), and providing an orientation to the local customer personnel. A typical installation can be completed in four to six hours. We are increasing our installation capabilities and currently can install 3,000 sites per month in the US.

Hub installation services vary, depending on whether the customer network involves a private hub or use of one of our shared hub facilities in Chicago, Atlanta, Germany and the Czech Republic as well as Argentina. The primary distinction between the two is that private hub installation involves more emphasis on site preparation, equipment installation and training, while shared hub installation focuses on the compatibility with the shared hub and host architecture.

We currently use in-house personnel for hub installation and third parties to perform most VSAT installation activity in our service markets. The program manager, working with our in-house

implementation staff, insures that our third-party installation teams arrive at the customer's site on schedule and are equipped with the necessary equipment to complete the installation. The third-party installers are trained and certified on the Gilat hardware platforms.

Shared Hub Services. The hub is the most costly and complex component of a VSAT system. Some customers prefer to outsource the management and operation of the hub, either by leveraging our competency in managing networks or by gaining additional cost efficiencies through sharing the hub hardware and operations costs with multiple customers. Gilat presently staffs its primary shared hubs in the U.S., Germany and Argentina, with a highly specialized technical staff on a 24-hour basis. Our shared hub service typically includes use of hardware, maintenance, ground-based backhaul circuits, and operations for which the customer pays a monthly fee.

Network Operations. Our network operations services coordinate and manage the operations of customers' networks and monitor the quality of services delivered on a 24-hour basis from one of our three network management centers (NMC). Our largest NMC is located in McLean, Virginia, and is staffed by over 40 technicians who are trained in network fault isolation, problem resolution and customer service. We also have NMCs in Germany and Argentina. When customers experience an outage on their network, they call the NMC, where a trained professional, using proprietary monitoring and control technology, will work to restore service. In instances in which service cannot be restored through the troubleshooting process, the NMC technician will dispatch one of our third-party field service technicians to repair or replace the on-site hardware and restore operations to the site.

In 1998, Gilat NMCs managed approximately 27,500 data and video sites in the United States and nearly 34,000 sites worldwide.

Maintenance. Once an NMC technician determines that a field service dispatch is required to fix a problem, our maintenance and logistics organizations provide service to the customer. We offer a variety of maintenance plans to support our customer networks. All of the plans include toll-free trouble reporting service from one of our NMCs, field service, replacement of equipment, warehousing of spare parts, shipping and repairs. The objective is to provide an on-site response within an average of four hours for most sites. In the United States, we have contracted with IBM-TSS, a third-party repair service provider, to operate nationwide service centers that are staffed with Gilat-trained and certified field service technicians. Other trained and certified third-party vendors are contracted in our international service markets.

Our maintenance services are supported by our internal logistics and repair organization, which is responsible for stocking parts in over 100 warehouses in the U.S., Europe and Argentina.

Customer Technical Services. Our technical services group includes engineering test and support services during the project implementation phase and on-going telephone and on-site support for complex networking issues. The customer technical services group provides application trouble shooting, network optimization, customer training, and documentation services.

Protocols and Methodologies. The development of new software protocols and methodologies has resulted in improved use of available network capacity and decreased delays in transmission of information. Our networks support multiple protocols simultaneously, including SDLC, Bisync, X.25, X.3/X.28/X.29 PAD, Token Ring LLC, Ethernet LLC, and TCP/IP. The performance of these protocols across satellite bandwidth is optimized by techniques such as TCP/IP "spoofing," which improves data throughput efficiency. In addition, our VSAT networks have built-in protocol conversion capabilities, including X.25 to Async PAD, SDLC to Token Ring, Bisync to Token Ring, and TCP/IP over Ethernet to TCP/IP over Token Ring, which allow our VSAT networks to operate with multiple protocols without the purchase of additional equipment. Our networks also support various methodologies, including frame relay, ATM and various others.

Satellite Capacity. Satellite transmission channels are an integral part of our VSAT network offers in the U.S., Europe and Argentina. We continually monitor our space segment capacity, all of which we procure from third parties, in order to ensure that sufficient transmission capacity is available for prospective customers, as well as growth in bandwidth for existing networks. The capacity is provided for the term of the agreement, typically five years, and may be increased under the term as the customer's traffic grows. For networks in the United States, we use satellite capacity acquired from GE Americom, which currently operates a fleet of 12 satellites, as well as from other suppliers. In connection with the Spacenet acquisition, we entered into a series of agreements with GE Americom under which GE Americom will provide us with backup and additional satellite services. These agreements are described below under the heading "Certain Relationships and Related Party Transactions—The Satellite Transponder Service Agreements." We also use capacity on several regional satellites in Europe and Argentina.

We believe that there is a large and growing quantity of satellite capacity available from a number of providers in the United States and in the rest of the world from whom we can obtain transmitter capacity at competitive rates, as our business requires.

Service Offerings. Service offerings combine a rental of all necessary network hardware with all of the above network services into an end-to-end customer solution. In a service offering, we retain ownership and operation of the network, delivering to the customer a specified network speed, response time and network availability for a set price per month per site. Generally, service offerings contracts have a five-year maturity. However, we intend to propose three-year contracts to respond to market demand.

Service offerings respond to our customers' needs to outsource non-core competencies and mitigate technical obsolescence and make the purchase of satellite network services similar to the procurement of ground-based network services.

To date, our service offerings have been based on the Skystar Advantage two-way data platform. However, we are leveraging our existing network services infrastructure to add new service offerings that include the SkySurfer and SkyBlaster product lines in the second half of 1999.

Marketing, Distribution and Strategic Alliances

Marketing and Distribution. We use both direct and indirect sales channels to market our products and services. Our marketing activities are organized geographically, with groups covering North America, Europe, Latin America, Asia and the rest of the world. In North America and Europe, most of our revenues are generated by our direct sales force, although value-added resellers and distributors account for some of our largest networks. In Asia and the rest of the world, we rely primarily on local agents and distributors. In all markets, we occasionally work with system integration companies for large and complex projects.

The sales teams are comprised of account managers and sales engineers, who are the primary account interfaces and work to establish account relationships and determine technical and business requirements for the network. These teams also support the other distribution channels with advanced technical capabilities and application experience. Sales cycles in the VSAT network market are lengthy and it is not unusual for a sale to require 18 months from initial lead through signature of the contract. The sales process includes several network design iterations, network demonstrations, pilot networks comprised of a few sites, and in some cases special software development which is completed before contract signing. For VSAT networks sold as a complete service offering, the sale cycle is typically shorter and can be as low as 90 days from the initial lead through the signature of the contract.

We have a sales and marketing group of 141 full-time employees (as of May 1, 1999) who offer our products and services, primarily in the United States and Europe. Approximately 48% of the sales and marketing group is based in the United States and approximately 18% is based in Europe. Sales of our services generally are substantial in size and involve a long-term complex sales process.

We currently have marketing and technical support staff in the United States, Europe and Israel. In addition, we maintain marketing and support offices in Argentina, Hong Kong, Brazil and Australia which provide ongoing marketing and technical support of our products for our strategic partners and their customers. These offices also work with our strategic partners to identify target markets and applications and define products to meet those needs. In addition, we have established a liaison office in India and representative offices in Thailand and Beijing to support our marketing efforts and support and coordinate local marketing offices in Central and South America and the Far East.

We also sell our products and services to postal, telephone and telegraph organizations ("PTTs") and other major carriers, resellers and other companies in the United States and internationally who purchase network products and services from us for resale to their customers. PTTs and other major carriers employ substantial sales forces and have the advantage of being existing providers to many of our target customers, which makes marketing easier and increases awareness of customer needs.

The following table sets forth Gilat's sales by geographic area for the periods indicated below as a percent of Gilat's total sales:

	Years Ended December 31,		
	1996	1997	1998
United States ¹	50.0%	49.5%	51.8%
Europe	7.6%	8.9%	6.7%
South and Latin America ²	6.8%	11.1%	6.9%
China	16.7%	4.6%	3.5%
Israel ³	3.8%	3.3%	2.7%
South Africa	0.0%	0.1%	13.4%
Other	15.1%	22.5%	15.0%
Total	100.0%	100.0%	100.0%

¹ Includes sales of 7.2%, 11.6% and 2.8% made through GTECH and Spacenet in the United States with shipments made directly to end-users in Europe (including regional service operators and distributors) for the years ended December 31, 1996, 1997 and 1998, respectively. See Note 15 of Notes to Consolidated Financial Statements listed in Item 19.

² Including sales made to a subsidiary of GTECH in Brazil of 1.4%, 6.8% and 1.1% for the years ended December 31, 1996, 1997 and 1998, respectively. See Note 15 of Notes to Consolidated Financial Statements listed in Item 19.

³ Includes sales to related parties of 13.2%, 3.6% and 8.2% for the years ended December 31, 1996, 1997 and 1998, respectively. See Note 15 of Notes to Consolidated Financial Statements listed in Item 19.

Strategic Alliances and Joint Ventures. In addition to our direct and indirect sales channels, we have established certain key strategic marketing relationships and joint ventures, including the following:

GTECH. Since 1990, we have worked closely with GTECH Corporation ("GTECH") to develop GTECH's GSAT service offering which is used for computerized on-line state and national lottery applications. GTECH is a leading operator and supplier of computerized on-line lottery systems. GTECH's lottery system consists of numerous remote lottery terminals located in retail outlets, central computer systems and game software, as well as communications equipment that connects the terminals and the central computer systems.

In December 1994, we executed a seven-year agreement with GTECH (replacing an agreement executed by the parties in March 1993) pursuant to which we agreed to sell our VSAT product components to GTECH at agreed-upon prices and granted GTECH certain non-exclusive marketing and manufacturing rights to our interactive transaction-oriented VSAT technology for worldwide gaming applications (except in France), including, among others, lotteries, sports betting, pari-mutuel betting and horse and other race betting. Under our agreement with GTECH, GTECH was required to purchase from us or manufacture, directly or indirectly through a subcontractor, specified quantities of IDUs (which are part of the remote terminal) through 1996, which quantities have been substantially satisfied. Purchases by GTECH of the indoor units (IDUs) from us are at the price specified in the agreement, and for IDUs manufactured by GTECH directly or through a subcontractor, GTECH is required to acquire the necessary software from us and to pay us a royalty in respect of each IDU produced.

The GTECH agreement also provides that until February 3, 2001, we will not, directly or indirectly, sell our two-way VSAT technology for gaming applications or supply services similar to those provided to GTECH under the agreement to any person directly or indirectly in competition with GTECH in the gaming business. However, we may sell our TwoWay VSAT (i) through Spacenet for resale to persons or entities involved in the gaming industry, and (ii) to value-added resellers who may sell the TwoWay VSAT for gaming applications.

Under a memorandum of understanding signed in March 1996, GTECH agreed to purchase or manufacture 1,500, 2,000, and 3,000 IDUs, respectively, in the three years of the agreement after 1996. Although the parties have conducted business pursuant to the memorandum of understanding, a restated agreement incorporating the terms of the memorandum of understanding is to be formalized subject to the approval of both companies. Those approvals may not be obtained, or the final agreement may contain terms different from those contained in the memorandum of understanding or the existing agreement.

ParaGea. In late 1992, we entered into a joint venture with COMSAT RSI, Inc. (the successor of which is ParaGea Communications) to develop, manufacture and market two-way rural telephone VSAT products. In March 1997, the parties modified the agreement to apply only to the VSAT-based telephony product which had been jointly developed and marketed by COMSAT RSI under the trade name "TerraSat 400" and by Gilat under the name "FaraWay VSAT"; to restructure the product development plans; and to grant each party non-exclusive marketing rights worldwide. In November 1997, a further amendment gave Gilat sole responsibility for development of the FaraWay product for a period of one year, after which both parties have the right to develop the product.

KSAT. In January 1998, we entered into an investment agreement with KSAT, a Yukon company listed on the Vancouver Stock Exchange, and Global Space Investments Limited, a partially owned subsidiary of Keppel Telecommunications & Transportation Ltd., a Singapore public company involved in telecommunications activities. Under the agreement, among other things, Global invested \$15 million in KSAT and we converted to equity certain convertible instruments we held in KSAT. We also agreed to exchange our direct interests in certain joint ventures in China for shares of KSAT, subject to Chinese government regulatory approvals. Those approvals have been obtained and we are in the process of completing the share exchange. In light of the 1998 KSAT financing and upon the transfer of our joint venture interests, we will hold approximately 39.0% of KSAT (or 30.8% on a fully diluted basis). Two of our officers have been appointed to the Board of Directors of KSAT.

Global Village Telecom N.V. ("GVT"). We initiated our rural telephony project in 1997 through our then wholly owned subsidiary, Global Village Telecom N.V. ("GVT"). GVT was established to design, deploy, manage and operate, alone or with local partners, rural telephony communications networks to provide fixed-site, basic telephony service to rural and remote markets in developing countries, as well as other markets for public telephony service. We currently market our DialAway VSAT product, and other voice products, through GVT and GVT's local partners. As of December 31, 1998, GVT had placed orders for approximately 1,000 DialAway VSATs and one hub for a rural telephony network in Chile where GVT won a concession to provide service to approximately 1,727 remote villages. GVT has also won a concession for the first phase, involving 213 sites, of a rural telephony system in Peru and has provided 93 DialAway VSATs and one hub for this network.

In April 1998, GVT completed a \$40 million private placement with an international group of investors, as a result of which our interest in GVT was reduced to approximately 5.7%. We invested \$2.5 million in GVT as part of the private placement. We also provided a \$7.5 million loan convertible into common shares equal to approximately 15% of GVT. Depending on several factors and the occurrence of certain events, we may further increase our holdings upon exercise of warrants to acquire additional common shares at par value, to a maximum holding in GVT of approximately 40%.

We have agreed, among other things, to supply GVT with its ongoing equipment needs, and with necessary approvals from the office of the Chief Scientist, to grant GVT certain co-ownership rights in the DialAway technology, pricing rights and manufacturing rights, as well as certain exclusive marketing rights with respect to the DialAway product. We cannot assure that GVT will locate suitable investment opportunities or partners, local operators or joint venture participants, that GVT will be profitable or that significant sales of our products will result.

Customers

Customers. The majority of the customers for our products and services are large retail and consumer-oriented businesses, including retail and consumer distribution, convenience stores, restaurants and hospitality, gas stations, hotel, brokerage, banking and financial services, communications, lottery, automotive and government. We sell our products directly to these customers or indirectly through resellers. In general, networks for these customers range from approximately 100 to 4,000 sites, although some customers have satellite data networks considerably smaller and others considerably larger than this range.

The Rite Aid drugstore chain uses its VSAT network to reduce network response time for credit card transactions, to process prescriptions through its pharmacy system, to broadcast customized music and promotional programming to its stores on its private radio frequency and to send frequent corporate communications and sales training updates to employees on its own business television system. Automaker Peugeot-Citroën of France uses its network for interactive data applications such as inventory updates, credit authorizations, and warranty documentation.

USPS Transaction. During 1998, we were selected as subcontractor, under a prime contract awarded to MCI Corporation, for the provision of VSAT services to the United States Postal Service. Although the contract does not require the USPS to purchase specific quantities at specific dates, the USPS program is expected to initially link 10,000 small associated office locations throughout the United States, with potential growth to 26,000 sites during the ten-year program—nearly three times the size of today's largest VSAT network. Our VSAT services will provide the USPS with a comprehensive upgrade to existing terrestrial dial-up services now in use at post offices across the United States. The new VSAT network—which utilizes commercial off-the-shelf technology—will provide post offices with full-time, on-line networking capabilities on an unprecedented scale. The network will support a wide range of applications, including point-of-sale and credit card processing, package delivery confirmation, remote

monitoring, software and data file downloading, IP multicasting, and multimedia broadcast. The network will provide the USPS with world-class connectivity to all locations, enabling a superior, state-of-the-art customer service infrastructure. The VSAT network will provide on-line services to as many as 26,000 locations. An additional 7,000 sites are being installed as back-up services to the existing MCI WorldCom Frame Relay network at large associated office locations. The USPS contract requires certain product functionality involving Turbosat technology purchased as part of the Spacenet acquisition as well as additional research and development. We have begun roll out of the first phase of the USPS network, with installation of approximately 2,500 sites by the end of June 1999, and have scheduled further installations at the rate of approximately 1,000 sites per month, although we cannot assure that we will be able to meet that schedule. Should we be unable to complete development of product functionality features required under the USPS contract or meet the roll out schedule under the contract, we could suffer a materially negative impact to our financial condition.

Competition

The data communications industry is highly competitive and the level of competition is increasing. As a provider of data network products and services in the United States and internationally, we compete with a large number of telecommunications service providers. Many of these competitors have significant competitive advantages, including long-standing customer relationships, close ties with regulatory and local authorities, and control over connections to local telephone networks. This increasingly competitive environment has put pressure on prices and margins. To compete effectively, we emphasize the price competitiveness of our products as compared to products offered by ground-based and other satellite service providers, the advantages of satellite data networks in general, our network quality, our customization capability, our offering of networks as a turnkey service rather than as an equipment sale and our provision of a single point of contact for products and services.

We have encountered strong competition from major established carriers such as AT&T, MCI WorldCom, Sprint, British Telecom, France Telecom, Deutsche Telekom and global consortia of PTTs and other major carriers, which provide international telephone, private line and private network services using their national telephone networks and those of other carriers. Such carriers also offer technological solutions for customer networks, including ISDN lines and frame relay networks. Fiber optic cable is increasingly available for wide bandwidth networks in the United States and Western Europe, and competitive issues often involve tradeoffs among price, various features and customer needs for specialized services or technologies. We are facing increasing competition from ground-based telecommunications service providers which use frame relay, fiber optic networks and digital network switching to provide competitive network offerings.

Our VSAT networks generally have an advantage over terrestrial networks where the network must reach many locations over large distances, where the customer has a "last mile" or congestion problem that cannot be solved easily with terrestrial facilities and where there is a need for transmission to remote locations or emerging markets, as discussed more fully above. By comparison, ground-based facilities (e.g., fiber optic cables) often have an advantage for carrying large amounts of bulk traffic between a small number of fixed locations. However, the customer's particular circumstances, the pricing offered by suppliers and the effectiveness of the marketing efforts of the competing suppliers also play a key role in this competitive environment.

The major telecom carriers also serve as resellers of our products and services, and are an increasingly important distribution channel in Asia and Latin America. See "—Marketing and Distribution"

Our principal competitor in the supply of satellite networks is Hughes Network Systems, which offers a full line of VSAT products and services and which obtains satellite capacity on the satellite system operated by its affiliates Hughes Galaxy and PanAmSat. In competing with Hughes Network Systems, we

emphasize particular technological features of our products and services, our ability to customize networks and perform desired development work, the quality of our customer service and our willingness to be flexible in structuring arrangements for the customer. In addition, we face competition from other satellite network providers, including Loral and its affiliates (such as Orion Network Systems) and, in certain instances, direct broadcast satellite companies.

We may experience increased competition in the future from these or other competitors that may adversely affect our ability to continue to market our products and services successfully. We believe that we have been able to compete successfully with larger telecommunications companies in part by entering into strategic joint development and marketing relationships with major companies such as GTECH and COMSAT RSI, by developing new products such as SkySurfer and SkyBlaster, and by emphasizing low-cost product and service features and functions that meet the needs of customers in the markets in which we compete. We are able to provide these product and service features and functions in part by using our proprietary hardware and software. See "—Patents and Intellectual Property."

We believe that our major competitors have the resources available to develop products with features and functions competitive with or superior to those offered by us. In addition, the entry of new companies into the market or the expansion by existing competitors of their product lines could have an adverse effect on us. However, we believe that our primary competitive advantage is our ability to provide products with relatively low overall cost and high functionality. We also compete on the basis of the performance characteristics of our products and our ability to customize certain network functions. We cannot assure that our competitors will not develop such features or functions, that we will be able to maintain a cost advantage for these products or that new companies will not enter these markets.

We also compete with other companies that offer communications networks and services based on other technologies (e.g., ground-based lines and frame relay, radio transmissions, point-to-point microwave) that can be competitive in terms of price and performance with our products. For example, there is a competing technology for a unidirectional VSAT system that uses a lower-cost remote terminal but requires more satellite space segments capacity than our unidirectional VSAT products. See "Risk Factors—Competition in the network communications industry."

Research and Development

Product Development. We devote significant resources to research and development projects designed to enhance our VSAT products, to expand the applications for which they can be used and to develop new products. As of December 31, 1998, approximately 24% of our employees in Israel and 16% of our employees in the United States were employed in research and development activities. Annual gross research and development expenditures were approximately 10.2%, 10.2% and 11.0% of sales in the years ended December 31, 1998, 1997 and 1996, respectively. Approximately 19.2%, 23.5% and 23.5% of our research and development expenditures for the years ended December 31, 1998, 1997 and 1996, respectively, were funded by the Office of the Chief Scientist, including funds received through the research consortia (as described below). Our initial research and development was funded by BIRD, but currently none of our research and development expenditures is funded by BIRD. We cannot assume that funding at any level will continue to be available or that funding will be available on attractive terms.

We intend to continue to devote research and development resources to complete development of certain features, to improve functionality, including supporting greater bandwidth, to improve space segment utilization, to increase throughput and to reduce the cost of our products.

We have devoted research and development resources to development of our DialAway VSAT. This product provides inexpensive, near toll quality, dial tone telephone service for small businesses and villages in remote or urban areas lacking an adequate telecommunications infrastructure. We intend to

continue development of the DialAway VSAT to develop new features, enhance existing features and reduce costs. We have contractually agreed to commit \$4.5 million in 1999 and \$2.8 million in 2000 to the development of certain technology related to this product. This technology will be co-owned with our affiliate, GVT. See "Marketing, Distribution and Strategic Alliances—Strategic Alliances and Joint Ventures."

We have developed the SkyBlaster VSAT product and will continue development of that product in connection with our efforts in the MOST Consortium (an Israeli generic technology research consortium described below). This product is an interactive VSAT that incorporates a satellite return channel, which enables two-way access to multimedia services via the Internet. The SkyBlaster is targeted for use in communities of interest, corporations, small to mid-size businesses and small office/home office users. The SkyBlaster is designed to offer improved access through better response time and faster downloading of large files, such as audio and video clips.

GE R&D → Our research and development efforts related to a product using the technology acquired in the Spacenet acquisition are intended to increase throughput, expand product features to serve additional applications and reduce costs. Our cost-reduction efforts are focused on greater integration of components, upgradeable VSAT platforms and higher data rates.

We develop our own network software and the software for all of our VSAT product lines. We generally license our software to customers as part of the sale of our network products and services.

We regard our software and our internally developed hardware as proprietary and have implemented protective measures both of a legal and practical nature. We have obtained and registered several patents in the United States and in various other countries in which we offer our products and services. We rely upon the copyright laws to protect against unauthorized copying of the object code of our software, and upon copyright and trade secret laws for the protection of the source code of our software. We derive additional protection for our software by licensing only the object code to customers and keeping the source code confidential. In addition, we enter into standard confidentiality agreements with our customers to protect our software technology and trade secrets. We have also made copyright, trademark and service mark registrations in the United States and abroad for additional protection of our intellectual property. Despite all of these measures, it is possible that competitors could copy certain aspects of our software or hardware or obtain information which we regard as a trade secret in violation of legal protections.

We periodically receive communications asserting that our products or applications thereof infringe a third party's patent rights or copyrights. We also send similar communications to third parties which we believe may be infringing our patents. There is no pending litigation against us regarding any infringement claim.

Third-Party Funding. Through December 31, 1998, we accrued a total of approximately \$2,245,000 in grants from the Office of the Chief Scientist for the development of our OneWay VSAT products, DialAway VSAT product, and mesh satellite communication network products for voice and data. Through that date, we have repaid all the royalties we are required to repay with respect to grants for the OneWay VSAT. Under the terms of our funding from the Office of the Chief Scientist for the DialAway product, royalties of 3% to 5% are payable on sales of these products developed from the funded project, up to 100% of the dollar-linked grant received in respect of the project. Through December 31, 1998, we accrued royalties of \$697,000 to the Office of the Chief Scientist for the DialAway project. The terms of these grants prohibit the manufacture of developed OneWay products or developed DialAway products outside of Israel and the transfer of technology developed pursuant to the terms of these grants to any person without the prior written consent of the Office of the Chief Scientist. We received such consent in connection with the OneWay product for the China joint ventures and will seek consent in connection with the DialAway product for our GVT investment. These restrictions do not apply to the sale or export

from Israel of products developed with that know-how. Also, these limitations do not apply to products which have not been funded by the Office of the Chief Scientist.

Through December 31, 1998, we received or accrued grants of approximately \$1.0 million from BIRD for the development of the Skystar Advantage VSAT and FaraWay VSAT products. Under the terms of BIRD funding, generally royalties of 2.5% to 5% on sales of products whose development is so funded are payable until 150% of the dollar amount funded (linked to the Consumer Price Index of the United States) is repaid. As of December 31, 1998, we have paid or accrued to BIRD approximately \$1.7 million in royalties. As of that date, we have completed repayment of royalties to BIRD with respect to our Skystar Advantage VSAT products and our FaraWay VSAT product.

Through December 31, 1998, we received grants of approximately \$125,000 from the European Commission in connection with a joint research and development project with a number of European high technology companies for a satellite-based interactive television platform.

Research and Development Consortium Participation. In addition to royalty-bearing grants from the Office of the Chief Scientist and BIRD, we have received grants from generic research consortia, each comprised of several major high technology companies in Israel which are being partially funded by the Office of the Chief Scientist. We expect to receive further grants from those consortia that are continuing. The consortia are:

- the Israel Satellite Earth Station Generic Research and Development Consortium (devoted to basic technology research for the satellite earth stations industry) which was completed by the end of 1998;
- the Israel Advanced Digital Communication Generic Research and Development Consortium (devoted to generic technology research of advanced digital communication) which was completed by the end of 1998;
- the GaAs MMIC Consortium (devoted to generic technology research of MMIC components and advanced communications);
- the MOST Consortium (devoted to generic technology research for on-line broadband multimedia services); and
- the ISIS Consortium (devoted to generic technology research for the information superhighway in space) which began in February 1999.

In general, any member of a consortium that develops technology in the framework of that consortium retains the intellectual property rights to technology developed and all the members of the consortium have the right to utilize and implement any such technology without having to pay royalties to the developing consortium member. Transfer of consortium-developed technology or manufacturing of developed products outside of Israel is subject to restrictions and the approval of the Consortium Committee of the Office of the Chief Scientist and of the management of the consortium.

Under each of the research consortia, the Office of the Chief Scientist contributes 66% of the approved budget for that consortium and the members of the consortium contribute the remaining 34%. No royalties are payable to the Israeli Government with respect to this funding. Expenses in excess of the approved budget are borne by the consortia members. As of December 31, 1998, we have accrued approximately \$9.6 million in grants from the Office of the Chief Scientist through the consortia, including \$0.9 million for equipment.

The following table sets forth, for the years indicated, our gross research and development expenditures, the portion of such expenditures which was funded by royalty-bearing and non-royalty bearing grants, acquired research and development and the net cost of our research and development activities:

	<u>Years Ended</u> <u>December 31,</u>		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
	(dollars in thousands)		
Gross research and development costs.....	\$8,129	\$10,615	\$15,815
Less:			
Royalty-bearing grants (the Office of the Chief Scientist And BIRD)	(276)	(464)	(997)
Non-royalty-bearing grants (the Consortia).....	(1,637)	(2,030)	(2,038)
Acquired research and development costs.....			80,000
Research and development costs—net.....	<u>\$6,216</u>	<u>\$8,121</u>	<u>\$92,780</u>

Manufacturing and Operations

Our products are designed, assembled, manufactured and tested at our facility in Petah Tikva, Israel, except for the ISAT frame relay systems and Gilat Florida's VSAT paging products which are designed, assembled, manufactured and tested at Gilat Florida's facilities in West Melbourne, Florida.

We have network operations centers at McLean, Virginia; Marietta, Georgia; Backnang, Germany and Argentina and shared hub facilities in Chicago, Illinois; Backnang, Germany; Argentina and the Czech Republic, from which we perform network services and customer support functions 24 hours a day, 7 days a week, 365 days a year. The network operations centers allow us to perform diagnostic procedures on customer networks and to reconfigure networks to alter data speeds, change frequencies and provide additional bandwidth.

Our current manufacturing facilities have sufficient capacity to handle current demand. To provide capacity for continued growth we completed by the end of 1997 the second phase of our new facility in Israel, as well as the expansion of the Florida facilities. We have begun a third and fourth phase of construction to add approximately 93,000 square feet and 79,000 square feet, respectively; the third phase is expected to be completed by the end of 1999 and the fourth phase by the end of the first quarter of 2001. We will have additional manufacturing capacity as a result of such expanded facilities. However, we cannot assure that the expected construction schedule will be met. See Item 2: "Description of Property".

Patents and Intellectual Property

We currently rely on a combination of patent, trade secret, copyright and trademark law, together with non-disclosure agreements and technical measures, to establish and protect proprietary rights in our products. We hold a United States patent for a commercial satellite communication system that allows random access to allotted frequency segments on satellites. The patented system allows our customers to utilize lower cost networks, while maintaining sufficient throughput and response times. Through Gilat Florida, we also hold a United States patent for the ISAT frame relay system. In addition, we also hold several patents relating to spread spectrum.

We believe that our patents are important to our business. We also believe, however, that the improvement of existing products, reliance upon trade secrets and unpatented proprietary know-how as well as the development of new products are generally as important as patent protection in establishing and maintaining a competitive advantage. We believe that the value of our products is dependent upon our proprietary software and hardware remaining "trade secrets" or subject to copyright protection. Generally, we enter into non-disclosure and invention assignment agreements with our employees and subcontractors. However, we cannot assure that our proprietary technology will remain a trade secret, or that others will not develop a similar technology or use such technology in products competitive with those offered by us.

We may, from time to time, be notified of claims that we may be infringing patents, copyrights, or other intellectual property rights owned by third parties. While we do not believe we are currently infringing any intellectual property rights of third parties, we cannot assure that other companies will not, in the future, pursue claims against us with respect to the alleged infringement of patents, copyrights or other intellectual property rights owned by third parties. In addition, litigation may be necessary to protect our intellectual property rights and trade secrets, to determine the validity of and scope of the propriety rights of others or to defend against third-party claims of invalidity. Any litigation could result in substantial costs and diversion of resources and could have a material adverse effect on Gilat's business, financial condition and operating results.

We cannot assure that infringement, invalidity, right to use or ownership claims by third parties or claims for indemnification resulting from infringement claims will not be asserted in the future. If any claims or actions are asserted against us, we may seek to obtain a license under a third party's intellectual property rights. We cannot assure, however, that a license will be available under terms that are acceptable to us, if at all. The failure to obtain a license under a patent or intellectual property right from a third party for technology used by us could cause us to incur substantial liabilities and to suspend the manufacture of the product covered by the patent or intellectual property right. In addition, we may be required to redesign our products to eliminate infringement if a license is not available. Such redesign, if possible, could result in substantial delays in marketing of products and in significant costs. In addition, should we decide to litigate such claims, such litigation could be extremely expensive and time consuming and could materially adversely affect our business, financial condition and operating results, regardless of the outcome of the litigation.

Government Regulation

Regulatory Overview. The international telecommunications environment is highly regulated. As a provider of communications services in the United States, we are subject to the regulatory authority of the United States, primarily the Federal Communications Commission (the "FCC"). We are also subject to regulation by the national communications authorities of other countries in which we provide service. Each of these entities can potentially impose operational restrictions on us. The changing policies and regulations of the United States and other countries will continue to affect the international telecommunications industry. We cannot predict the impact that these changes will have on our business or whether the general deregulatory trend in recent years will continue. We believe that continued deregulation would be beneficial to us, but also could reduce the limitations facing many of our existing competitors and potential new competitors.

We are required to obtain approvals from numerous national and local authorities in the ordinary course of our business in connection with most arrangements for the provision of services. The necessary approvals generally have not been difficult for us to obtain in a timely manner. However, the failure to obtain particular approvals has delayed, and in the future may delay our provision of services. Moreover, it is possible that any approvals that may be granted may be subject to materially adverse conditions.

United States Regulation. All entities that use radio frequencies to provide communications services in the United States are subject to the jurisdiction of the FCC under the Communications Act of 1934, as amended (the "Communications Act"). The Communications Act prohibits the operation of satellite earth station facilities and VSAT systems such as those operated by us except under licenses issued by the FCC. Major changes in earth station or VSAT operations require modifications to the FCC licenses, which must also be approved by the FCC. The licenses we hold are granted for ten year terms. The FCC generally renews satellite earth station and VSAT licenses routinely, but we cannot assure that our licenses will be renewed at their expiration dates or that such renewals will be for full terms. In addition, certain aspects of our business may be subject to state and local regulation including, for example, local zoning laws affecting the installation of satellite antennas.

International Regulation. We must comply with the applicable laws and obtain the approval of the regulatory authority of each country in which we propose to provide network services or operate VSATs. The laws and regulatory requirements regulating access to satellite systems vary from country to country. Some countries have substantially deregulated satellite communications, while other countries maintain strict monopoly regimes. The application procedure can be time-consuming and costly, and the terms of licenses vary for different countries. In addition, in some countries there may be restrictions on our ability to interconnect with the local switched telephone network.

Employees

Including the staff of Spacenet, we had approximately 960 full-time employees as of May 1, 1999, including 160 employees in administration and finance, 141 employees in marketing and sales, 191 employees in engineering, research and development and 426 employees in manufacturing, operations and technical support. Of these employees, 419 were based in our facilities in Israel, 459 were employed in the United States, 60 in Europe, 20 in Asia and the Far East, and the balance in other parts of the world.

We also utilize temporary employees, as necessary, to supplement our manufacturing and other capabilities. We believe that our relations with our employees are satisfactory.

We and our employees are not parties to any collective bargaining agreements. However, certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) ("Histadrut") and the Coordination Bureau of Economic Organizations (including the Manufacturers' Association of Israel) are applicable to Israeli employees by order (the "Extension Order") of the Israeli Ministry of Labor and Welfare. These provisions principally concern the length of the work day and the work week, minimum wages for workers, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment. Furthermore, pursuant to such provisions, the wages of most of our employees are automatically adjusted based on changes in the Israeli CPI. The amount and frequency of these adjustments are modified from time to time.

Israeli law generally requires severance pay upon the retirement or death of an employee or termination of employment without due cause. We currently fund our ongoing severance obligations by making monthly payments to approved severance funds or insurance policies. In addition, Israeli employees and employers are required to pay specified sums to the National Insurance Institute, which is similar to the U.S. Social Security Administration. Since January 1, 1995, such amounts also include payments for national health insurance. The payments to the National Insurance Institute are approximately 14.6% of wages (up to a specified amount), of which the employee contributes approximately 66% and the employer contributes approximately 34%. The majority of our permanent employees are covered by life and pension insurance policies providing customary benefits to employees,

including retirement and severance benefits. For Israeli employees, we contribute 13.33% to 15.83% (depending on the employee) of base wages to such plans and the permanent employees contribute 5% of base wages.

CONDITIONS IN ISRAEL

We are incorporated under the laws of, and our offices and manufacturing facilities are located in, the State of Israel. Accordingly, we are directly affected by political, economic and military conditions in Israel. Our operations would be materially adversely affected if major hostilities involving Israel should occur or if trade between Israel and its present trading partners should be curtailed.

Political and Economic Conditions

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. However, a peace agreement between Israel and Egypt was signed in 1979, a peace agreement between Israel and Jordan was signed in 1994 and, since 1993, several agreements between Israel and Palestinian representatives have been signed. In addition, Israel and several other Arab States have announced their intention to establish trade and other relations and are discussing certain projects. As of the date hereof, Israel has not entered into any peace agreement with Syria or Lebanon. There is substantial uncertainty about how the "peace process" will develop or what effect it may have upon us.

Despite the progress towards peace between Israel, its Arab neighbors and the Palestinians, certain countries, companies and organizations continue to participate in a boycott of Israeli firms. We do not believe that the boycott has had a material adverse effect on us, but there can be no assurance that restrictive laws, policies or practices directed towards Israel or Israeli businesses will not have an adverse impact on the expansion of our business.

As discussed below, (see Item 9: "Management's Discussion and Analysis of Financial Condition and Results of Operations—Impact of Inflation and Currency Fluctuations"), the costs of our operations in Israel are generally incurred in NIS. If the inflation rate in Israel exceeds the rate of devaluation of the NIS against the dollar in any period, the costs of our Israeli operations, as measured in dollars, could increase. Israel's economy has, at various times in the past, experienced high rates of inflation.

Trade Agreements

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation. Israel is a signatory to the General Agreement on Tariffs and Trade, which provides for reciprocal lowering of trade barriers among its members. In addition, Israel has been granted preferences under the Generalized System of Preferences from Australia, Canada and Japan. These preferences allow Israel to export the products covered by such programs either duty-free or at reduced tariffs.

Israel and the European Union concluded a Free Trade Agreement in July 1975 that confers certain advantages with respect to Israeli exports to most European countries and obligates Israel to lower its tariffs with respect to imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area ("FTA"). The FTA has eliminated all tariff and certain non-tariff barriers on most trade between the two countries. On January 1, 1993, Israel and the European Free Trade Association ("EFTA") entered into an agreement establishing a free-trade zone between Israel and the EFTA nations. In recent years, Israel has established commercial and trade relations with a number of other nations, including Russia, the People's Republic of China and nations in Eastern Europe, with which Israel had not previously had such relations.

Risk Factors; Forward-Looking Statements

The following factors, in addition to other information contained in this annual report on Form 20-F should be considered carefully.

This annual report on Form 20-F includes certain statements that are intended to be, and are hereby identified as, "forward looking statements" for the purposes of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties, and assumptions about Gilat, including, among other things:

- our anticipated growth strategies
- our intention to introduce new products
- anticipated trends in our business, including trends in the market for communication network products and services
- future expenditures for capital projects
- our ability to continue to control costs and maintain quality

These statements may be found in Item 1: "Description of Business" and Item 9: "Management's Discussion and Analysis of Financial Condition and Results of Operations," and in this annual report on Form 20-F generally. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in "Risk Factors" and elsewhere in this annual report on Form 20-F.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties, and assumptions, the forward-looking events discussed in this annual report on Form 20-F might not occur.

Integration of the newly acquired Spacenet with Gilat

On December 31, 1998, we completed the acquisition of Spacenet and its subsidiaries and certain foreign affiliates and are working towards integration with Gilat of Spacenet's facilities, personnel, research and development efforts and subsidiaries. The integration diverts substantial attention of our senior management team from Gilat's daily operation and places significant pressure on our staff and other resources. The integration poses financial, operational and legal risks, and any failure to integrate Spacenet successfully could have a material adverse effect on our business and operating results.

In addition, we face several challenges which stem from our assumption of Spacenet's product lines, services and customer base. With the acquisition of Spacenet, we are entering the satellite service business; prior to the acquisition, our business was limited to satellite equipment. Moreover, in 1997 and 1998, Spacenet was our largest customer, accounting for approximately 34% and 45% of our revenues respectively. We will need to market Spacenet products and services which are new to our operation. We will also be required to provide product support and other services to Spacenet end-users who have certain dated or non-Gilat products historically offered by Spacenet. We cannot assure that we will be able to perform these commitments successfully and on a cost-effective basis. As a result of the Spacenet acquisition, we incurred restructuring expenses of \$14.2 million for the year ended December 31, 1998 mainly for compensation to customers and other third parties, \$9.5 million of inventory write off relating to rationalization of product lines, and \$2.7 million of write off of investments associated with restructuring which have no alternative use.

We may also be unable to successfully achieve full integration of Spacenet with Gilat. Such integration may be impeded by general economic conditions, failure to integrate Spacenet's financial and operating systems, adverse response of competitors or clients, or regulatory developments. As a result, the expected operating synergies and cost savings may not be realized and Gilat's business, financial condition and operating results could be materially adversely affected.

History of losses at Spacenet

In 1996, 1997 and 1998, for periods prior to the acquisition, Spacenet reported net losses of \$3.4 million, \$18.5 million and \$3.1 million, respectively. We have, pursuant to the procedures of the Merger Agreement, objected to certain aspects of the Spacenet balance sheet as reported for 1998 which may result in adjustments showing losses higher than those reported for that year. Any such adjustments to the balance sheet would not have an impact on our business, financial condition or operating results. See Item 13: "Interest of Management in Certain Transactions - Merger Related Agreements - Post-Closing Adjustments". Spacenet's losses can be attributed in part to the lack of adequate financial and operating controls and systems and difficulties in integrating previous acquisitions. Our success in reversing this historic trend of net losses depends on implementing cost-saving steps such as elimination of redundant overhead, implementing more rigorous operational and financial controls and focusing on a streamlined product line while growing Spacenet's sales and customer base. A new enterprise resource planning system is being implemented at Spacenet and is expected to be operational by September 1, 1999, although we can not assure that this schedule will be met. Continuation of Spacenet's net losses would have a material adverse effect on our business, financial condition and operating results.

Potential liabilities under agreements related to our merger with Spacenet

In connection with our acquisition of Spacenet, we entered into a Merger Agreement and a series of related agreements. The Merger Agreement contemplates post-closing adjustments which may require us to pay certain amounts to GE Americom or to issue additional Ordinary Shares to GE Americom. In addition, we have undertaken to indemnify GE Americom from and against certain losses which may arise from our breach of our representations and warranties and certain other obligations. See Item 13: "Interest of Management in Certain Transactions—Merger-Related Agreements."

Potential change in allocation of purchase price of Spacenet acquisition

On December 31, 1998, we recorded a charge of \$80 million for the write-off of acquired in-process research and development associated with the Spacenet acquisition (the "IPR&D Write-off"). In-process research and development expenses arise from new product development projects that are in various stages of completion at the acquired enterprise at the date of acquisition. The amount of the IPR&D Write-off is based on an independent appraiser's report obtained by management.

In-process research and development write-offs have recently been examined by the SEC. While we believe that the IPR&D Write-off is consistent with applicable accounting rules, the methods and techniques by which such rules are applied are still being developed by the accounting profession, at the guidance of the SEC. The SEC has not reviewed the IPR&D Write-off for the Spacenet acquisition. Any adjustments in the allocation to in-process research and development would result in an increase in intangible assets which would be required to be amortized over their estimated useful lives and a decrease in operating and net income for future periods which may impact on the price of the Ordinary Shares. Regardless of the outcome of any discussions regarding the IPR&D Write-off, there would be no cash impact.

If we were to reclassify a portion of the purchase price that was allocated to in-process research and development to intangible assets, for each \$10 million reclassified to intangible assets, both our intangible assets and earnings (loss) before income taxes for our 1998 fiscal year would increase

*Assume \$40m
reclass. cost;
• \$667,000 decrease
per quarter*

(decrease) by the same amount. Assuming that the intangible assets that would result from this reallocation of the purchase price had a 15 year useful life, we would report an approximately \$667,000 increase in annual amortization expense, and a \$667,000 decrease in net income before taxes, for each \$10 million reclassified.

Risks associated with new product research and development in process at Spacenet

An important part of the Spacenet acquisition was the purchase of Spacenet's ongoing research and development of advanced interactive VSAT technology. We believe that this technology represents a significant advance over currently available technology. Spacenet had been developing a product using this technology under the name of Turbosat; we plan to continue this product's research and development and to market the resulting product under our own name. However, we cannot assure that all aspects of this new technology will ever reach the feasibility stage or that if it does reach this stage, that it will be developed in time to obtain a competitive advantage. In addition, even if all of the features of the product are developed in time, we cannot assure that the product will be developed in a cost-effective manner.

Ability to manage our rapid growth and expansion

We have grown significantly in the last few years and expect to continue to grow rapidly. This growth is likely to place a significant strain on our resources and systems, as we expand our manufacturing, testing, quality control, delivery and service operations. In particular, we are in the process of implementing a new management information system to assist in managing our anticipated growth.

We cannot assure that we will be able to meet all our product delivery and service commitments or that we will be able to implement successfully the new management information system. Inability to manage our growth effectively will expose us to potential loss of customers, contractual penalties, damage to reputation and various costs and expense. This could have a material adverse effect on our business, financial condition and operating results.

Dependence on a limited number of large sales and limited number of products

A significant portion of our sales are derived from large-scale contracts with major customers. Generally, we are selected as suppliers of these customers in a bid process. The number of major bids for VSAT-based networks in any given year is limited and the competition is intense. Our losing a relatively small number of bids could have a significant adverse impact on our operating results. In addition, the USPS contract does not require the USPS to purchase any specific number of VSATs by any specific date. See Item 1: "Description of Business—Customers—USPS Transaction."

In addition, in recent years we have derived more than half of our sales from our SkyStar Advantage product. Any change in the market acceptance of this product, or of other key products such as our telephony products, could have a material adverse effect on our business.

Need to develop, introduce and market new products and services

Our market is characterized by rapid technological changes, frequent new product announcements and evolving industry standards. Significant technological changes could render our existing products and technology obsolete. To be successful, we must anticipate changes in technology and industry standards and continuously develop and introduce new products and services as well as enhancements to existing products and services. If we are unable to address the needs of our customers successfully and to respond to technological advances on a cost-effective and timely basis, or if new products are not accepted by the market, then our business, financial condition and operating results could be adversely affected.

Backlog of orders may not be filled and contracts may not be renewed

At present, we have a substantial backlog of orders, consisting of network service contracts, generally for three to five years, and of new orders for products and services. We may be unable to fill all the backlog or to fully recognize the revenues expected from this backlog for any of the following reasons:

- Existing service contracts can be terminated due to customers' dissatisfaction with the service we provide
- Existing contracts may be terminated because of our inability to timely provide and install additional products or requested new applications

The loss of existing contracts and a decrease in the number of renewals of orders or of new large orders, would have a material adverse effect on our business, financial condition and operating results. In addition, a portion of our service contracts are short-term with expiration or cancellation upon 90 days' notice or less. If a substantial number of our service customers choose to cancel or not to renew their contracts, our business could be adversely affected.

Potential delays in the supply of components required to build our VSATs

Several of the components required to build our VSATs are manufactured by a limited number of suppliers. In the past we have not experienced any difficulties with our suppliers. However, we can not assure the continuous availability of key components or our ability to forecast our component requirements sufficiently in advance. Any interruption in supply would cause delays in manufacturing and shipping products. Those delays and the cost of developing alternative sources of supply could have a material adverse effect on our business, financial condition and operating results.

Dependence on availability of satellite transponder space

Our VSAT-based services depend on satellite transponder space purchased from third-party suppliers. For networks in the United States, we primarily use satellite capacity acquired from GE Americom. We also use capacity on several regional satellites in Western and Eastern Europe, Latin America, India and other areas of Asia. In connection with our acquisition of Spacenet, we entered into a series of agreements with GE Americom. These agreements provide protected services for customer networks on transponders on three satellites currently operated by GE Americom and on one satellite to be constructed, operated and launched by GE Americom, as well as certain preemptible services for in-house use on an additional satellite operated by GE Americom. See Item 1: "Description of Business-Satellite Capacity" and Item 13: "Interests of Management in Certain Transactions—The Satellite Transponder Agreements." We cannot assure that this transponder capacity will be sufficient to meet our growing needs, or that we will be able to obtain additional transponder space at competitive prices from GE Americom or from other suppliers should we need to do so. In addition, our transponder service contracts generally do not provide for alternative services in the event of satellite failure, and we do not maintain insurance against such failures. Therefore, if a satellite becomes inoperable, and alternative services are not available, our revenues would be adversely affected.

Potential competition with existing customers

With the acquisition of Spacenet, we will be entering the VSAT service industry. As service providers, we will be competing with certain existing customers for our products who provide VSAT-related services to end-users. These customers could consequently sever their business relationships with us or, alternatively, we may elect to refrain from selling additional products to them. The loss of those

customers, some of whom may be significant, could have a material adverse effect on our business, financial condition and operating results.

Competition in the network communications industry

Gilat operates in a highly competitive industry of network communications. Many of our competitors have substantially greater financial resources, providing them with greater research and development and marketing capabilities. These competitors are also more experienced in obtaining regulatory approvals for their products and services and in marketing them. Our relative position may place us at a disadvantage in responding to our competitors' pricing strategies, technological advances and other initiatives.

Gilat's principal competitor in the supply of data networks is Hughes Network Systems ("Hughes"), which offers a full line of VSAT products and services. Hughes obtains satellite capacity on the satellite system operated by its affiliates Hughes Galaxy and PanAmSat.

The following table lists additional competitors of Gilat:

<u>Competitor</u>	<u>Area of Competition</u>
NEC Corporation	FaraWay VSAT system
Comstream Corp.	FaraWay VSAT system
ViaSat Inc.	FaraWay VSAT system
Titan Information Systems Corp.	DialAway VSAT system
STM Wireless, Inc.	DialAway VSAT system
ACT Networks, Inc.	ISAT Frame relay system
GlobeComm Systems Inc.	ISAT Frame relay system
Engineering Technical Services Inc.	ISAT Frame relay system
EF Data Corp.	Unidirectional broadcast products
SpaceCom Systems, Inc.	Unidirectional broadcast products

In addition, Gilat competes with various companies that offer communication network systems based on other non-satellite technologies such as terrestrial lines (including ISDN lines and fiber optics), frame relay, radio and microwave transmissions. These technologies can often be cheaper than VSAT technology while still providing a sufficient variety of the features required by customers. Competitors of this type include major established carriers such as AT&T, MCI Worldcom, Sprint, British Telecom, Deutsche Telekom, France Telecom, global consortia of PTTs and others.

Dependence on proprietary VSAT technology

Proprietary rights are important to our success and our competitive position. We establish and protect the proprietary rights and technology used in our products by the use of patents, trade secrets, copyrights and trademarks. We also utilize non-disclosure and invention assignment agreements.

Our actions to protect our proprietary rights may be insufficient to prevent others from developing similar products to ours. In addition, the laws of many foreign countries do not protect our intellectual property rights to the same extent as the laws of the United States.

Dependence on our key management and technical personnel

We believe that our success depends on the continued employment of the following senior management team:

<u>Name</u>	<u>Position</u>	<u>Employment Agreement</u>
Yoel Gat	Chairman and Chief Executive Officer	Year-to-year
Amiram Levinberg	President and Chief Operating Officer	Year-to-year
Yoav Leibovitch	Vice President, Finance and Administration and Chief Financial Officer	Year-to-year

If any of our key personnel is unable or unwilling to continue in his present position, our business, financial condition and operating results could be materially adversely affected.

Competition for personnel, particularly for employees with technical expertise, is intense. Our business, financial condition and operating results will be materially adversely affected if we cannot hire and retain suitable personnel.

Dependence on a single facility makes us susceptible to its condition

Most of our manufacturing capacity, our principal offices and principal research and development facilities are concentrated in a single location in Israel.

Fire, natural disaster or any other cause of material disruption in our operation in this location could have a material adverse effect on our business, financial condition and operating results. In addition, the particular risks relating to our location in Israel are described below.

Risks relating to our international sales and operations

We sell and distribute our products and also provide our services internationally, particularly in the United States, Europe and Latin America. A component of our strategy is to continue to expand into new international markets, such as China and South America. Our operations can be limited or disrupted by various factors known to affect international trade. These factors include the following:

- imposition of governmental controls and regulations
- export license requirements
- political instability
- trade restrictions and changes in tariffs
- difficulties in staffing and managing foreign operations
- longer payment cycles and difficulties in collecting accounts receivable
- seasonal reductions in business activities

Difficulties in obtaining regulatory approvals for our telecommunication services

Our telecommunication services require licenses and approvals by the FCC in the United States, and by regulatory bodies in other countries. The approval process can often take substantial time and require substantial resources, and any approvals that may be granted may be subject to materially adverse conditions. In addition, even after obtaining the required approvals the regulating agencies may, at any time, impose additional requirements. We can not assure our ability to comply with any new requirements on a timely or economic basis.

Limitation on production outside of Israel and on transfer of technology

Because some of our products were developed with Israeli governmental financial support, we cannot manufacture them or transfer the technology embodied in them outside of Israel without governmental approval. Those approvals, if granted, may be conditioned, among other things, upon significantly higher royalty payments to the Israeli government. See Item 7: "Taxation."

Fluctuations in operating results and volatility of share price

Our operating results may vary significantly from quarter to quarter. Historically, we have recognized a greater proportion of our revenues in the last quarter of each year. The causes of fluctuations include, among other things:

- the timing, size and composition of orders from customers
- our timing of introducing new products and product enhancements and the level of their market acceptance
- the mix of products and services we offer
- the changes in the competitive environment in which we operate

The market price of our Ordinary Shares has been subject to volatility and could be subject to wide fluctuations in response to numerous factors, many of which are beyond our control. These factors include the following:

- actual fluctuations or anticipated variations in our operating results
- announcements of technological innovations
- customer orders or new products or contracts
- competitors' positions in the market
- changes in financial estimates by securities analysts
- conditions and trends in the VSAT and other technology industries
- our earnings releases and the earning releases of our competitors
- the general state of the securities markets (with particular emphasis on the technology and Israeli sectors thereof)

In addition, the stock market in general, and the market for technology companies in particular, has been highly volatile. Investors may not be able to resell their shares following periods of volatility.

The trading prices of many technology-related companies' stocks have recently reached historical highs and have reflected relative valuations substantially above historical levels. These trading prices may not be sustained.

Potential of litigation due to intellectual property infringements

From time to time we receive communications asserting that our products or their applications infringe on a third party's proprietary rights. Currently, there is no pending litigation against us regarding any intellectual property claim, and we do not believe that we are infringing on any other party's rights, but we cannot assure that there will not be future claims. Such claims, with or without merit, could subject us to costly litigation and divert our technical and management personnel from their regular responsibilities. Furthermore, successful claims could suspend the manufacture of products using the contested invention, and have a material adverse effect on our business, financial condition and operating results.

Potential product liability claims

We may be subject to legal claims relating to the products we sell or the services we provide. Our agreements with our customers generally contain provisions designed to limit our exposure to potential product liability claims. We also maintain a product liability insurance policy. Our insurance may not cover all relevant claims or may not provide sufficient coverage. To date, we have not experienced any material product liability claims. Our business, financial condition and operating results could be materially adversely affected if costs resulting from future claims are not covered by our insurance or exceed our coverage.

Concentration of control over Gilat

GE Americom beneficially owns approximately 23.84% of our outstanding Ordinary Shares as of June 16, 1999. GE Americom and several other principal shareholders, who beneficially own (including options exercisable within 60 days) an additional approximately 10.11% of our Ordinary Shares, have entered into a shareholders' agreement. As a result of this agreement, a group of our principal shareholders, collectively owning only about 33.95% of our outstanding Ordinary Shares, is able to exercise effective control over most of our business. For a review of the shareholders' agreement including certain exceptions to the above, see Item 13: "Interest of Management in Certain Transactions—The Shareholders' Agreement." In addition, Israeli law requires a minimum 75% of the shareholders to approve certain significant corporate changes, including merger and consolidation. Consequently, subject to the terms of the Shareholders' Agreement, GE Americom could block approval of such resolutions.

No intention to pay dividends

We have never paid cash dividends on our Ordinary Shares and do not anticipate paying any cash dividends in the foreseeable future. We intend to retain any earnings for use in our business. In addition, the terms of some of our financing arrangements restrict us from paying dividends to our shareholders.

Availability of Israeli Government benefits to our company

Under the Israeli Law for Encouragement of Capital Investments, 1959, facilities that meet certain conditions can apply for an "Approved Enterprise" status. This status confers certain benefits including tax benefits. All of our existing facilities have been designated as "Approved Enterprises." Our historical operating results reflect substantial tax benefits which amount to approximately \$1,592,000, \$3,872,000 and \$341,000 for 1996, 1997, and 1998, respectively.

In addition, under the Law for Encouragement of Research and Development, 1984, we have received research and development grants from the Office of the Chief Scientist of the Ministry of Trade and Industry of the State of Israel (the "Office of the Chief Scientist"). These grants are repayable from royalties on sales of products developed with these grants. Under the terms of the grants, we are required to manufacture these products in the State of Israel unless we receive a permit from the Office of the Chief Scientist to manufacture abroad. If we receive a permit to manufacture abroad, we may be required to pay a higher royalty rate on sales of these products, and we may also be required to repay a greater overall amount. In addition, we have received grants from research consortia that are partly funded by the Office of the Chief Scientist. The consortia grants do not require the payment of royalties.

During 1996, 1997 and 1998, we accrued \$1,950,000, \$2,494,000 and \$2,910,000, respectively in royalty-bearing and non-royalty-bearing grants from the Office of the Chief Scientist.

The Government of Israel has indicated its intention to reexamine its policies in these areas. The Israeli Government has also shortened the period of the tax exemption applicable to "Approved Enterprises" from four years to two years. This change only applies to our last three "Approved Enterprises" and to any future "Approved Enterprises" if any. See Item 1: "Description of Business—Research and Development; Third-Party Funding."

With respect to repayment of grants from the Office of the Chief Scientist, in 1997, the Government increased the annual rate of royalties from between 2% to 3% of associated product sales to between 3% and 5% of associated product sales (including service and other related revenues). Israeli authorities have also indicated that the grant program may be further reduced in the future.

We cannot be sure that these and other governmental programs and tax benefits will be continued in the future at their current levels or at all. The termination or reduction of the benefits available to us would significantly increase our costs and could have a material adverse effect on our business, financial condition and operation results. See Item 7: "Taxation."

In addition, in order to maintain our eligibility for the grants and tax benefits we receive, we must continue to meet certain conditions, including making certain investments in fixed assets and operations. If we fail to meet such conditions in the future, we could be required to refund tax benefits already received, with interest and linkage differences to the Israeli Consumer Price Index (the "Israeli CPI").

Impact of inflation and foreign currency fluctuations

Our international sales expose us to fluctuations in foreign currencies. Substantially all of our sales are denominated in US dollars. Conversely, a significant portion of our expenses, mainly salaries, is incurred in NIS and is linked to the Israeli CPI. When the Israeli inflation rate exceeds the rate of the NIS devaluation against the foreign currencies, then our NIS expenses increase to the extent of the difference between the rates. A significant disparity of this kind may have a material adverse effect on our operating results.

Risks relating to our location in Israel

We are incorporated under the laws of the State of Israel, where we also maintain our headquarters and most of our manufacturing facilities. Political, economic and military conditions in Israel directly influence us. Since the establishment of the State of Israel in 1948, Israel and its Arab neighbors have engaged in a number of armed conflicts. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Despite the progress towards peace between Israel and its Arab neighbors and the Palestinians, major hostilities may revive. Such hostilities may hinder Israel's international trade and lead to economic downturn. This, in turn, could have a material adverse effect on our operations and business.

Generally, male adult citizens and permanent residents of Israel under the age of 51 are obligated to perform 14 to 31 days of military reserve duty annually, depending on their age. Additionally, all such residents are subject to being called to active duty at any time under emergency circumstances. The full impact on our workforce or business if some of our officers and employees are called upon to perform military service is difficult to predict. See "Conditions in Israel."

Year 2000 compliance

The Year 2000 issue is the result of computer programs being written using two digits rather than four to define the applicable year. In other words, date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in system failures or miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices or engage in similar normal business activities. Furthermore, vendors who provide critical infrastructure services (e.g., electricity, water, telephone) or other critical services (e.g. sub-assemblies, outsourcing of manufacturing and parts) may encounter Year 2000 problems.

We may realize exposure and risk if the systems on which we are dependent to conduct our operations or the vendors on whose services we are dependent are not Year 2000 compliant. Our potential areas of exposure include certain products purchased from third parties, computers, software, telephone systems and other equipment used internally. In addition, certain of the older VSAT platforms installed by Spacenet may not be Year 2000 compliant and may require upgrading or replacement. We do not expect the cost of such upgrades or replacements to be material.

We are currently in the process of developing our computer software applications and systems to accommodate Year 2000 compliance. To date, we have undertaken a program to identify all our critical systems and suppliers. We have assessed these in terms of Year 2000 readiness and we have identified those requiring replacement or remediation. Our remediation or replacement program is planned to be completed by year end.

We have already spent on Year 2000 compliance approximately \$300,000 and expect to spend approximately another \$325,000 by year end 1999. The cost of upgrades or replacements, while significant, is not expected to be material to our financial position or results of operations. The funds necessary for achieving Year 2000 compliance are part of our working capital.

As indicated, as part of this program, we are currently conducting an analysis to determine the extent to which key distributors, vendors and suppliers have Year 2000 issues. This is being accomplished by receiving written responses from our critical distributors, vendors and suppliers in which they indicate their Year 2000 readiness. We cannot assure that all necessary upgrades or replacements can be successfully identified and completed on time or that the systems of the vendors on whose services we are dependent are properly certified as being Year 2000 compliant. If our present efforts to address the Year 2000 compliance issues are not successful, or if distributors, suppliers and other third parties with which we conduct business do not successfully address such issues, our business, financial condition and operating results could be materially and adversely affected.

The Merger Agreement relating to our acquisition of Spacenet required us to develop a schedule for achieving Year 2000 compliance by June 30, 1999 (with certain limited exceptions). This schedule was prepared and submitted to GE Americom and we are currently in the process of providing them with updates as to the status of the program.

Uncertainty of enforceability of civil liabilities against foreign persons

Our directors and officers and the Israeli experts named in this annual report on Form 20-F reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, because the majority of our assets are located in Israel, any judgment obtained in the United States against us or any of our directors and officers may not be collectible within the United States.

ITEM 2: DESCRIPTION OF PROPERTY

In April 1996, we moved to approximately 62,000 square feet of office, manufacturing and warehousing facilities in Petah Tikva, Israel, which was expanded by an additional 57,000 square feet at the end of 1997. We purchased approximately 93,000 square feet of additional facilities in 1997 for a contract price of approximately \$17.4 million, including taxes and related expenses. We have paid a majority of the purchase price, with the remainder to be paid during construction, which is expected to be completed at the end of 1999. We have also exercised our contractual option to acquire approximately 79,000 square feet of space, including parking and commercial space, at a price of approximately \$16.6 million including taxes and related expenses. Preliminary construction has begun and is expected to be completed by the end of the first quarter 2001. In addition we have (i) purchased 34,120 square feet of additional space in an adjoining building, at a price of approximately \$3.2 million; and (ii) acquired an additional 65,000 square feet of adjoining real property for future expansion.

We currently maintain a 7,500 square foot facility in Yokneam, Israel for software research and development at a monthly rental of \$4,650; the lease is for five years, with an option for an additional five years.

The current facility of Gilat Florida in West Melbourne, Florida houses the Gilat Florida executive, sales, manufacturing, and research and development activities, under a ten-year lease which began May 1, 1997 at a current monthly rental of approximately \$15,938.

Our offices in McLean, Virginia comprise approximately 70,000 square feet. These offices house not only our personnel, but also contain one of our U.S. network operations centers. The lease covering these facilities expires in April 2005. We also lease a facility in Marietta, Georgia comprising approximately 70,000 square feet, which is used for certain assembly and repair functions and a second Gilat U.S. network operations center as well as space in Manassas, Virginia, Chicago, Illinois and Houston, Texas for sales and operations personnel and for equipment storage. Our European business leases a 21,000 square foot facility in Backnang, Germany, which is used by our European-based management, sales and operations personnel and contains our European network operations center. We maintain offices in Tulsa, Oklahoma, Atlanta, Georgia, Paris and Hong Kong, and in South America, in Brazil, Argentina, Colombia and Mexico, along with representative offices in Beijing and in Thailand and we also lease office space in London, Prague, Amstelveen, São Paulo, Buenos Aires and New Delhi, and small facilities in other locations.

Petah Tikva office, mfg., & warehousing space:

April 96	62,000	
Dec 97	+ 57,000	
97	+ 93,000	
	+ 34,120	49
<hr/>		
246,120 sq. ft.		
250,000 sq. ft.		

Yokneam software R&D:
7,500 sq. ft.

ITEM 3: LEGAL PROCEEDINGS

We are a party to various legal proceedings incident to our business, most of which were assumed in our acquisitions and are still the subject of various indemnities obtained in such acquisitions. Except as noted below, there are no material legal proceedings pending or, to our knowledge, threatened against us or our subsidiaries, and we are not involved in any legal proceedings that our management believes, individually or in the aggregate, would have a material adverse effect on our business, financial condition or operating results.

In March 1999, we settled an arbitration proceeding brought by Shanghai V-Tech Telecommunications Systems Co., Ltd. ("V-Tech"), an affiliate of GTS TeleSystems Group, Inc. ("GTS") in connection with the purchase of VSAT equipment for a system in China.

On January 4, 1999, Gilat Satellite Networks Inc. was named as a defendant in an action filed in the Circuit Court for Montgomery County, Maryland entitled *Hughes Network Systems v. David Shiff, Sheldon Revkin, and Gilat Satellite Networks, Inc.* Plaintiff Hughes Network Systems seeks to enjoin Sheldon Revkin and David Shiff from working for Gilat in its Spacenet operations, and to enjoin Gilat from employing them for a limited period of time. The amended complaint alleges misappropriation of trade secrets and interference with commercial relations and seeks unspecified damages. On January 14, 1999, Judge William Turner of the Circuit Court signed a temporary order forbidding Revkin and Shiff from divulging any of Hughes' technical trade secrets, but denied plaintiff's request for an order enjoining Revkin and Shiff from doing their jobs for Gilat. We have filed a motion to dismiss the amended complaint and for attorney fees. We do not believe the proceedings will prevent Messrs. Shiff and Revkin from performing their roles at Spacenet or that any judgment will have a material adverse impact on our business, financial condition or operating results.

We are also a party to various regulatory proceedings incident to our business. To the knowledge of our management, none of such proceedings is material to us or to our subsidiaries.

ITEM 4: CONTROL OF REGISTRANT

as of
June 16, 1999

The following table sets forth certain information with respect to the beneficial ownership of our Ordinary Shares as of June 16, 1999 (including options exercisable within 60 days) with respect to: (i) each person who is believed by us to be the beneficial owner of more than 5% of the Ordinary Shares; and (ii) all directors and officers as a group. Except where otherwise indicated, we believe, based on information furnished by the owners, that the beneficial owners of the Ordinary Shares listed below have sole investment and voting power with respect to such shares, subject to any applicable community property laws.

<u>Name and Address</u>	<u>Number of Ordinary Shares Beneficially Owned</u>	<u>Percent of Ordinary Shares Outstanding</u>
GE Americom(1) 3135 Flaston Turnpike Fairfield, Connecticut 06431-0001	5,000,000	23.84
Pilgrim Baxter & Associates(2)..... 825 Duportail Road Wayne, PA 19087	1,183,600	5.64
Wellington Management Company, LLP(2)..... 75 State Street Boston, Massachusetts 02109	1,634,490	7.79
All officers and directors as a group (18 persons)(3)	1,212,766	5.78

- (1) Excludes 292,699 Ordinary Shares held indirectly by General Electric Company through various subsidiary companies, including mutual funds and pension trusts managed by General Electric Company.
- (2) Based on information available to Gilat.
- (3) Includes 340,390 Ordinary Shares for which options to 15 executive officers are currently exercisable within 60 days but have not yet been exercised, but does not include 182,418 Ordinary Shares held by DIC Financial Management Ltd. ("DICFM") of which Dov Tadmor (a current Director of Gilat) may be deemed a beneficial owner. Mr. Tadmor disclaims beneficial ownership of such shares. PEC Israel Economic Corporation ("PEC"), a Maine corporation, and DICFM, an Israeli corporation, are controlled by Discount Investment Corporation Ltd. ("DIC"), which is in turn controlled by IDB Development Corporation Ltd. ("IDBD"). Companies controlled by Dina Recanati, Elaine Recanati, Leon Y. Recanati and Judith Yovel Recanati, together beneficially own approximately 51.6% of the equity and voting power in IDB Holding Corporation Ltd. ("IDBH"), the parent of IDBD. Dina Recanati and Elaine Recanati are sisters-in-law and the aunts of Leon Y. Recanati and Judith Yovel Recanati, who are brother and sister. Leon Y. Recanati is co-Chairman of the Board of Directors and co-Chief Executive Officer of IDBH and co-Chairman of the Board of Directors of IDBD. Based on the foregoing, IDBH and IDBD (by reason of their control of DIC), DIC (by reason of its control of PEC and DICFM) and Dina Recanati, Elaine Recanati, Leon Y. Recanati and Judith Yovel Recanati, may be deemed to share with PEC and DICFM the power to vote and dispose of the Ordinary Shares held by such companies. For information with respect to a voting agreement and shareholders agreement entered into by certain shareholders, see Item 13: "Interest of Management in Certain Transactions."

ITEM 5: NATURE OF THE TRADING MARKET

Our Ordinary Shares are quoted on the Nasdaq National Market under the symbol "GILTF." The following table sets forth, for the periods indicated, the range of high and low closing sale price for the Ordinary Shares, as reported by Nasdaq:

	<u>High</u>	<u>Low</u>
1996:		
First Quarter	\$28.875	\$22.125
Second Quarter	\$24.250	\$19.500
Third Quarter	\$22.250	\$16.250
Fourth Quarter	\$26.500	\$17.250
1997:		
First Quarter	\$36.500	\$26.625
Second Quarter	\$36.750	\$27.000
Third Quarter	\$37.063	\$31.250
Fourth Quarter	\$40.500	\$27.000
1998:		
First Quarter	\$36.500	\$22.500
Second Quarter	\$39.250	\$30.500
Third Quarter	\$46.125	\$32.313
Fourth Quarter	\$56.375	\$37.500
1999:		
First Quarter	\$63.000	\$52.250
Second Quarter (to June 22)	\$60.750	\$47.875

As of June 16, 1999 there were 104 record holders of Ordinary Shares, of which 94 represented U.S. record holders owning an aggregate of approximately 95.5% of the outstanding Ordinary Shares.

We have never paid cash dividends to our shareholders and we currently do not intend to pay dividends for the foreseeable future. We intend to reinvest earnings in the development and expansion of our business. We have decided to reinvest permanently the amount of tax exempt income derived from our "Approved Enterprises" and not to distribute such income as dividends. See Note 10 of Notes to the Consolidated Financial Statements listed in Item 19. We may only pay cash dividends in any fiscal year out of "profits," as determined under Israeli law. In addition, the terms of certain financing arrangements restrict us from paying dividends to our shareholders.

In the event we declare dividends in the future, we will pay those dividends in NIS. Because exchange rates between NIS and the dollar fluctuate continuously, a U.S. shareholder will be subject to currency fluctuation between the date when the dividends are declared and the date the dividends are paid.

ITEM 6: EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS

Non-residents of Israel who purchase any of our Ordinary Shares with certain non-Israeli currencies (including the dollar) and through an authorized foreign currency dealer bank will be able to convert dividends, liquidation distributions and the proceeds from the sale of such Ordinary Shares into freely repatriable non-Israeli currencies at the rate of exchange prevailing at the time of conversion (provided that Israeli Income Tax has been paid or withheld on such amounts).

ITEM 7: TAXATION

Nonresidents of Israel are subject to income tax on income accrued or derived from sources in Israel or received in Israel. These sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. Gilat is required to withhold income tax at the rate of 25% (15% for dividends generated by an Approved Enterprise) on all distributions of dividends other than bonus shares (stock dividends), unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. Under the income tax treaty between the United States and Israel (the "Treaty"), the maximum tax on dividends paid to a holder of Ordinary Shares who is a United States resident (as defined in the Treaty) is 25%.

Israeli law imposes a capital gains tax on the sale of securities and other capital assets. Under current law, however, gains from sales of the Ordinary Shares of Gilat are exempt from Israeli capital gains tax for so long as (i) the shares are quoted on Nasdaq or listed on a stock exchange recognized by the Israeli Ministry of Finance and (ii) Gilat qualifies as an Industrial Company or Industrial Holding Company under the Law for Encouragement of Industry (Taxes), 1969. Furthermore under the Treaty, a holder of Ordinary Shares who is a United States resident will be exempt from Israeli capital gains tax on the sale, exchange or other disposition of such Ordinary Shares unless such holder owns, directly or indirectly, 10% or more of the voting power of Gilat.

A nonresident of Israel who receives interest, dividend or royalty income derived from or accrued in Israel, from which tax was withheld at the source, is generally exempt from the duty to file tax returns in Israel with respect to such income, provided such income was not derived from a business conducted in Israel by the taxpayer.

Israel presently has no estate or gift tax.

ITEM 8: SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data of Gilat gives retroactive effect to the acquisition of Spacenet which has been accounted for as a purchase. The selected consolidated statement of operations data set forth below with respect to the years ended December 31, 1994, 1995, 1996, 1997 and 1998 and the consolidated balance sheet data as of December 31, 1994, 1995, 1996, 1997 and 1998 have been prepared in accordance with Israel GAAP and U.S. GAAP (as applied to Gilat's financial statements, such accounting principles are practically identical) and audited by Kesselman & Kesselman, independent certified public accountants in Israel and a member of Pricewaterhousecoopers International Limited. The selected consolidated financial data set forth below should be read in conjunction with Item 9: "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and Notes thereto included in Item 19 in this Form 20-F.

YEARS ENDED DECEMBER 31,

	1994 ⁽¹⁾	1995 ⁽¹⁾	1996 ⁽¹⁾	1997	1998
(In thousands, except per share data)					
Statement of Operations Data:					
Sales	\$37,924	\$54,532	\$74,126	\$103,690	\$155,335
Cost of sales:					
Cost of products sold	21,403	31,483	42,917	58,742	86,603
Write-off of inventories associated with restructuring					9,495
	<u>21,403</u>	<u>31,483</u>	<u>42,917</u>	<u>58,742</u>	<u>96,098</u>
Gross profit.....	<u>16,521</u>	<u>23,049</u>	<u>31,209</u>	<u>44,948</u>	<u>59,237</u>
Research and development costs:.....					
Expenses incurred	4,148	6,532	8,129	10,615	15,815
Less-grants.....	<u>1,397</u>	<u>1,066</u>	<u>1,913</u>	<u>2,424</u>	<u>3,035</u>
	2,751	5,466	6,216	8,121	12,780
Acquired research and development.....					80,000
Net research and development costs.....	<u>2,751</u>	<u>5,466</u>	<u>6,216</u>	<u>8,121</u>	<u>92,780</u>
Selling, general and administrative expenses	<u>7,047</u>	<u>9,544</u>	<u>13,945</u>	<u>20,321</u>	<u>29,077</u>
	6,723	8,039	11,048	16,506	(62,620)
Restructuring charges					14,239
Merger expenses			7,991		
Operating income (loss).....	6,723	8,039	3,057	16,506	(76,859)
Financial income (expenses)—net.....	(105)	575	1,170	538	(1,247)
Write-off of investments associated with restructuring					(2,700)
Other income (expenses)—net.....	(1)		1,329	30	162
Income (loss) before taxes on income.....	6,617	8,614	5,556	17,074	(80,644)
Taxes on income	<u>139</u>		<u>84</u>	<u>130</u>	<u>286</u>
Income (loss) after taxes on income.....	6,478	8,614	5,472	16,944	(80,930)
Share in losses of associated companies					703
Net income (loss)	<u>\$6,478</u>	<u>\$8,614</u>	<u>\$5,472⁽²⁾</u>	<u>\$16,944</u>	<u>(\$1,633)</u>
Earnings(loss) per share:					
Basic.....	<u>\$0.72</u>	<u>\$0.92</u>	<u>\$0.51⁽²⁾</u>	<u>\$1.56</u>	<u>(\$7.38)⁽²⁾</u>
Diluted.....	<u>\$0.71</u>	<u>\$0.89</u>	<u>\$0.50⁽²⁾</u>	<u>\$1.51</u>	<u>(\$7.38)⁽²⁾</u>
Weighted average number of shares used in computation of earnings (loss) per share — in thousands.....					
Basic.....	<u>9,007</u>	<u>9,413</u>	<u>10,816</u>	<u>10,895</u>	<u>11,059</u>
Diluted.....	<u>9,071</u>	<u>9,632</u>	<u>11,049</u>	<u>11,255</u>	<u>11,059</u>

Balance Sheet Data:	DECEMBER 31,				
	1994	1995	1996	1997	1998
			(In thousands)		
Working capital.....	\$21,144	\$61,623	\$61,632	\$85,081	\$68,694
Total assets.....	45,215	97,423	112,201	211,960	410,284
Short-term bank credit and current Maturities of long-term debt.....	1,205	4,806	582	2,719	23,158
Long-term debt.....	1,500	13	-	75,000	75,000
Shareholders' equity.....	35,471	81,563	89,758	108,338	220,370

⁽¹⁾ Includes the results of Gilat Florida into which a wholly-owned subsidiary of Gilat was merged on December 30, 1996, and accounted for pursuant to the pooling-of-interests method.

⁽²⁾ If the merger expenses associated with the Gilat Florida Merger had not been included in Gilat's results, net income for the year ended December 31, 1996 would have been approximately \$13,463,000 and basic earnings per share for that year would have been \$1.24 and diluted earnings per share would have been \$1.22.

⁽³⁾ If the restructuring charges, write offs associated with restructuring and expenses related to acquired research and development associated with the Spacenet Acquisition had not been included in Gilat's results, net income for the year ended December 31, 1998 would have been approximately \$24,801,000 and basic earnings per share for that year would have been \$2.24 and diluted earnings per share would have been \$2.14.